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No.

In the

Supreme Court of the United States

OCTOBER TERM 1971

ELLA MILNARIK, EMILY MILNARIK, FLORENCE MILNARIK, BRUCE TURNMIRE, JEAN MILNARIK, RONALD MILNARIK, MARSHALL W. MILNARIK,

Petitioners,

vs.

M-S COMMODITIES, INC., an Illinois corporation, and DAVID S. NELSON,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

To the Honorable Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Petitioners respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Seventh Circuit affirming the judgment for respondents of the District Court on January 28, 1972; the order of said Court of Appeals entered March 13, 1972 denying petitioners a rehearing; and, since the Court of Appeals affirmed for reasons differing

from those of the District Court, petitioners further pray that this Court review the judgment and opinion of the United States District Court for the Northern District of Illinois, Eastern Division, entered October 26, 1970.

OPINIONS BELOW

The opinion of the Court of Appeals for the Seventh Circuit is reported at 457 F.2d 274. The opinion of the District Court is reported at 320 F. Supp. 1149. Both opinions are set out in the Appendix hereto.

JURISDICTION

The date of judgment of the Court of Appeals is January 28, 1972. The petition for rehearing, timely filed by petitioners, was denied by order of said Court on March 13, 1972. This petition is filed within 90 days from said date. Jurisdiction of this Court is invoked under 28 USC § 1254(1).

QUESTIONS PRESENTED

(1) Whether the Court of Appeals erred by holding that each discretionary commodity trading agreement which respondents solicited from and entered into with petitioners and many residents of the several states was not a security as that term is defined in § 2(1) of the Securities Act of 1933 (15 USC § 77b(1)) because the court could find no common enterprise analogous to a classical corporate structure?

(2) If such an agreement is a security, is it exempt from registration under § 5 of the Act (15 USC § 77e) as a transaction not involving a public offering under § 4(2) (15 USC § 77d(2))?

STATUTORY PROVISIONS INVOLVED

Section 2(1) of the Securities Act of 1933 (15 USC § 77b(1) provides:

> "When used in this title, unless the context otherwise requires—
>
> "(1) the term 'security' means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a 'security,' or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."

Section 4(2) of said Act (§ 77(d)2) provides:

> "The provisions of Section 5 shall not apply to—
> "(2) transactions by an issuer not involving any public offering.

Section 5 of said Act (§ 77(e)) in pertinent part, provides:

> "(a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—
>
> (1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise;
>
> • • •

"(c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, * * *"

Section 12(1) of said Act (§ 77l(1)) provides:

"Any person who—

"(1) offers or sells a security in violation of Section 5,

* * *

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security."

Section 22(a) of the Act (§ 77(v)) provides, in pertinent part:

"The district courts of the United States, * * * shall have jurisdiction * * * of all suits in equity and actions at law brought to enforce any liability or duty created by this title. * * *"

The pertinent provisions of the Commodity Exchange Act (7 USC §§ 1 et seq.) appear in the appendix.

STATEMENT

Petitioners, Illinois residents, brought this action under said § 77l(1) seeking damages for the offer and sale to them by respondents of discretionary commodity futures trading agreements, no registration statements therefor being in effect. Jurisdiction of the District Court was founded on Section 22 of the Act (§ 77v).

The complaint alleged that in September, 1969 respondent Nelson, a California resident, solicited petitioner Marshall W. Milnarik through the mails and sold to him his commodity futures trading advisory bulletin. Thereafter Nelson telephoned Milnarik, informed him that he was an experienced and professional commodity trader and was engaged in the business of trading commodity futures for customers' accounts; that he had been successful in managing accounts and making profits for his customers in the commodity markets; that if Milnarik would invest $5,000.00 with him he would accept such a managed, discretionary account from him, and would trade commodity futures contracts for and would make a profit for him. Nelson stated that his compensation for his services would be taken from commissions generated by his trading for Milnarik.

The complaint further alleges that pursuant to said solicitation Marshall W. Milnarik deposited $5,000.00 with Nelson on November 1, 1969. Nelson in turn deposited the funds with his principal, a broker, the respondent M-S Commodities, Inc. Thereafter said petitioner, also pursuant to said solicitation, deposited additional funds in his own account and $6,500.00 in six other accounts which Nelson opened and traded for the other petitioners. Nelson traded all the accounts at his sole discretion, giving all orders to his principal to buy and sell commodities futures contracts therein. All of petitioners' funds were lost by Nelson's trading plus additional sums for which the broker, M-S, has sued petitioners in a separate action.

Petitioners further alleged that the contracts for the investment of their funds "were part of a large, nationwide scheme which defendants promoted among and entered into with numerous residents of the several states."

Respondents moved to dismiss petitioners' complaint for want of jurisdiction. The District Court assumed that it had jurisdiction and that the discretionary commodity trading agreements with petitioners were "securities" as defined in the Act, § 77b (1), but dismissed the complaint on its own motion for failure to state a cause of action, holding such securities to be transactions not involving any public offering, i. e., exempted transactions to which the registration provisions of Section 5 do not apply. The Court of Appeals* affirmed the judgment for respondents on the ground that the discretionary trading agreements were not securities.

The Court of Appeals and the District Court both based their opinions on findings that there was no "common enterprise" involved in respondents' scheme as that term was used by this Court in the definition of an "investment contract", *SEC* v. *Howey Co.*, 328 US 293 at 298, 299, 301.

The Court of Appeals held that although the language of the complaint described an investment contract covered by the Act by a literal interpretation of the statutory words, nevertheless judicial analyses of the question whether particular investment contracts are "securities" within the statutory definition have repeatedly stressed the significance of finding a common enterprise. 457 F.2d at 275, 276. Because each of the many contracts involved in the scheme was "unitary in nature", the reviewing court found that there was no common enterprise and hence the investment contracts of plaintiffs were not to be included in the statutory definition of a security.

---

* Judge Kerner heard oral argument but did not participate in the opinion.

The District Court, although assuming that the petitioners' trading agreements were securities, held that the relationship between Nelson, M-S and each petitioner and each of the many other offerees throughout the several States was unitary in nature, that a common enterprise was lacking; hence, that the solicitation of each account was a private offering exempt from registration under § 77e.

REASONS FOR GRANTING THE WRIT

The Court of Appeals and the District Court have decided important questions of federal securities law which have not been, but should be, decided by this Court because of their bearing not only upon the subject matter of the instant case, viz., discretionary commodity trading agreements, but also upon the general body of securities law.

The Court of Appeals, in deciding that the instant discretionary agreements, albeit investment contracts under a literal interpretation of the statutory words, were not securities has placed a gloss on the term "common enterprise", as used by this Court in defining an investment contract, (*SEC* v. *Howey Co.*, 328 US 293, 1945) which greatly restricts the applicability of the Securities Act of 1933, and therefore, *a fortiori*, the Securities and Exchange Act of 1934 since the definitions of a security in both Acts are substantially the same. By said decision, we respectfully submit, the Court of Appeals has decided this federal question in conflict with applicable decisions of this Court and has thereby restricted the definition of the term "security" to economic structures analogous to the classical corporate structure. Such restriction was not intended by Congress, as decisions of this Court have made clear.

The decision of the court below is in conflict with decisions of the district courts in three circuits, the earliest of which, *SEC* v. *Wickham*, 12 F.Supp. 245 (DC Minn. 1935) held that such discretionary managed trading accounts were securities and granted an injunction to the Commission enjoining their offer or sale without registration. This decision was followed in recent years by the excellent opinion of Judge Bonsal in a case on all fours with the case at bar in *Maheu* v. *Reynolds Co.*, 282 F.Supp. 423 (SDNY 1967), and in the same year by another pro-

ceeding by the Commission in an unreported case, *SEC* v. *Commodity Brokerage Co., Inc.*, Civil 1967—105 (WDPa), which terminated in a consent decree enjoining the offer and sale by defendant of such accounts or agreements since the same were securities. In another proceeding in the same District, *W. J. Abbott & Co.* v. *SEC*, 276 F.Supp. 502 (WDPa 1967), the court refused to quash a Commission subpoena calling for the production of records dealing with managed trading accounts since they were held to be within the purview of the Acts. These cases were followed in 1968 by *Berman* v. *Orimex Trading, Inc.*, 291 F.Supp. 705 (SD NY), a case again on all fours with the one below which held, as did *Maheu*, that these managed accounts are securities and the investors therein entitled to civil relief as provided in the Acts.

We cite these cases to show that for 37 years the commodity brokerage business has been operating under what has been assumed to be a settled question of federal law. There is no reported decision of which counsel have knowledge other than that of the court below which holds that such discretionary trading agreements are not securities as the term is defined in the Acts.

The decision of the Court of Appeals thus removes the civil and criminal restraints of the 1933 and 1934 Acts which have been effective for 37 years to discourage discretionary trading agreements in the commodity brokerage business and the many "get rich quick" promises of over zealous brokers, customers men and promoters who seek to use the funds of the uninitiated investor to make a profit for themselves. This is especially important both because of the circuits in which the conflicting decisions have been rendered and of the national economic importance of commodity trading. The Eighth Circuit includes within

its geographic limits the Minneapolis and Kansas City Grain Exchanges. The Seventh Circuit contains the Board of Trade of the City of Chicago and Chicago Mercantile Exchange which together account for the bulk of all commodity futures trading. The Second Circuit includes the New York Mercantile Exchange, Coffee and Sugar Exchange, Cotton Exchange, Produce Exchange, and Commodity Exchange. Statistics developed by the U. S. Department of Agriculture reveal that the volume of commodity trading in grains, livestock and meat products, regulated by the Commodity Exchange Authority, has risen sharply in late years. (CEA—Annual Summary of Commodity Futures Statistics). The value of commodities traded on the Chicago exchanges alone in 1971 exceeded 128 billion dollars in over 11.7 million futures contracts. (Yearbooks, Board of Trade of the City of Chicago and Chicago Mercantile Exchange, 1971)

The decision of the Court of Appeals denies the protections of full disclosure provided by registration (Sec. 5 of the Securities Act of 1933) as well as those afforded by Sec. 10 b (5) of the Securities and Exchange Act of 1934 to a large and rapidly growing number of unsophisticated investors who are regularly solicited in the popular and financial press, through the mails and the electronic media, to participate in the exciting and highly volatile commodity markets and who are then led, generally to their loss, to place funds in discretionary trading accounts with soliciting traders and brokers.

The importance of the issue is further demonstrated by the fact that there are now pending in the United States District Court (ND Ill ED) cases involving discretionary commodity trading agreements in which the decision of the court below has been raised by defendants and in

which action has been stayed pending the outcome of this petition. In *Herr* v. *Siegel Trading Company,* 70 C 2738, the plaintiff, a resident of Germany, seeks relief under the 1933 and 1934 Acts for the loss of $72,000.00 in a discretionary account. $30,000.00 of the plaintiff's loss was attributable to commissions generated by the promoter and shared by him and the broker. In *Fishwick* v. *Siegel Trading Company,* 71 C 2114, the same broker is sued by other counsel for damages in excess of $30,000.00, again under the 1933 and 1934 Acts. Counsel for petitioners, just prior to the decision of the court below, settled another case brought under the 1933 Act. *Graber* v. *Stein-Kohn & Co.,* 71 C 440.

The District Court, assuming that the discretionary agreements were securities, held that they were private offerings and thus exempt from registration; however the District Court said they were unitary in nature, not part of a common enterprise and thus *per se* transactions not involving a public offering. Such a holding by that court raises for the first time the contention that a security can by its very nature be a "private offering" since not part of a common enterprise. The District Court's decision errs in two particulars: First, it uses "common enterprise," not as this court did in *Howey,* op. cit., to determine whether the investment contracts were securities, but to determine whether securities are private offerings. Secondly, the District Court has looked at the character of the security and not at the need of the offeree to determine the public or private character of the offering. This is a novel and totally unwarranted approach in conflict with this court's decision in *SEC* v. *Ralston Purina Co.,* 346 US 119 (1952) which held that it is the need of the offeree for the Act's protection which determines whether an offering is public or private, not the character of the

security or the number of persons to whom it is or might be offered.

I.

BECAUSE OF THE IMPORTANCE OF THE ISSUE RAISED BY THE DECISION BELOW, BOTH AS REGARDS THE GENERAL BODY OF SECURITY LAW AND ITS EFFECT ON THE COMMODITY BROKERAGE BUSINESS, THIS COURT SHOULD GRANT REVIEW.

a.

By misconstruing the term "common enterprise" used by this Court in defining an investment contract as a security (Howey, op. cit.), the Court below has limited the definition of the term "security" in a way intended neither by this Court nor by the Congress, thereby deciding a federal securities law question in conflict with decisions of this Court.

The misconstruction of this Court's holding in *Howey*, op. cit., and in *SEC* v. *Joiner Leasing Corp.*, 320 US 344, is raised by the lower court in the following stages, first by its acknowledgment that:

> "Plaintiffs' position that the language of the complaint describes an investment contract covered by the Act is supported by two district court decisions* and by a literal interpretation of the statutory words." (457 F.2d 274, 275)

---

* *Maheu* v. *Reynolds* and *Berman* v. *Orimex*, both op. cit. The question of whether the discretionary agreements were securities was not briefed, the "private offering" issue being the only one raised in the appeal. The other apposite cases, *SEC* v. *Wickham, W. J. Abbott & Co.* v. *SEC* and *S.E.C.* v. *Commodity Brokerage Co., Inc.*, all op. cit., were cited in the petition for rehearing.

and its statements:

> "Nevertheless, we do not believe every conceivable arrangement that would fit a dictionary definition of an investment contract was intended to be included within the statutory definition of a security. We are 'reminded that in searching for the meaning and scope of the word "security" in the Act, form should be disregarded for substance and the emphasis should be on economic reality.' (*Tcherepnin* v. *Knight,* 389 U.S. 332, 336.)"

followed by:

> "Judicial analyses of the question *whether particular investment contracts are 'securities' within the statutory definition have repeatedly stressed the significance of finding a common enterprise.*" (P. 276) (emphasis supplied)

and then its quotation from the District Court's opinion:

> "These plans (*Howey,* op. cit.; *Continental Marketing Corp.* v. *SEC,* 387 F.2d 466 (1969)) in other words were all sales of units in a common enterprise *no different in operating reality from the sale of stock by a corporation . . .*" (pg. 278) (Emphasis supplied).

We believe the Court of Appeals then decided a question of federal law in conflict with the rule of *Howey* and *Joiner* for two reasons:

First: In *SEC* v. *Joiner Leasing Corp.,* 320 US 344 at 351, this Court said:

> "In the Securities Act the term 'security' was defined to include by name or description many documents in which there is common trading for speculation or investment. Some, such as notes, bonds, and stocks, are pretty much standardized and the name alone, carries well settled meaning. Others are of more variable character and were necessarily designated by

more descriptive terms, such as 'transferable share,' 'investment contract,' and 'in general any interest or instrument commonly known as a security.' We cannot read out of the statute these general descriptive designations merely because more specific ones have been used to reach some kinds of documents. *Instruments may be included within any of these definitions, as matter of law, if on their face they answer to the name or description. However, the reach of the Act does not stop with the obvious and commonplace.* Novel, uncommon, or irregular devices, whatever they appear to be, are also reached if it be proved as matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as 'investment contracts', or as 'any interest or instrument commonly known as a 'security.'" (Emphasis supplied).

The facts alleged in petitioners' complaint clearly establish an investment contract, as a matter of law. They are admitted by the defendants' motion and the terms are clear: Nelson solicited one of the petitioners, told him he was an experienced manager of commodity accounts, agreed to accept and then received $5,000.00 and thereafter additional deposits which he agreed to and did use, at his sole discretion, to buy and sell commodity futures contracts for the accounts of petitioners upon his promise to make a profit for them, taking commissions as his profit in the scheme. If this agreement were reduced to writing it would, we submit, as a matter of law "on its face *** answer to the *** description" of an investment contract. That the alleged agreement was oral does not change its character. (Cf. *SEC* v. *Addison,* 194 F.Supp. 709, 722 (DC Tex. 1961); also 1 Loss, Securities Regulation 488, 2d ed. 1961). An investment has been defined as "the placing of capital or laying out of money in a way intended to secure income or profit from its employment." *State* v. *Gopher*

Tire & Rubber Co., 177 N.W. 937, 938 (cited in *Howey*, op. cit., 298) and, this Court said in *Howey*, an investment contract thus came to mean "a contract or scheme for 'the placing of capital or laying out of money in a way intended to secure income or profit from its employment.'" (idem) This, we opine, is the basic definition of an investment contract. This court then defined an investment contract for purposes of the Securities Act:

> "In other words, an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise." (*Howey*, op. cit. pgs. 298, 299)

The court below has erred by misconstruing the term "common enterprise" used in the foregoing definition thus limiting the scope of the definition to "sales of units in a common enterprise no different in operating reality from the sale of stock by a corporation." (457 F. 2d at 278)

In *Howey*, as well as in *Continental Marketing* and the other property sale cases, the courts found the element of a common enterprise. When this was added to what otherwise would have been merely real or tangible personal property sales and management agreements the court found a security. In other words, in those cases the courts found that the sum was equal to something more than the total of the parts. None of the sales or management agreements in itself was, as a matter of law, a security. Integrated, however, they revealed a common enterprise and this court and the other courts found that the character of the whole pervaded each element so that each ele-

ment became a contract for an investment in a larger reality and hence a security.

In the case at bar, however, it is not necessary to integrate the many discretionary accounts into a common enterprise, certainly not one of corporate character, in order to imbue each with the character of an investment contract. Each account *is* an investment contract, *per se*, i. e., an agreement for the laying out of money in a way intended to secure a profit. Since the investor expects to profit solely through the efforts of the promoter it becomes a security for purposes of the Security Act. It is thus either the element of common enterprise or sole reliance upon the efforts of another which brings an investment contract within the pale of the Act.

This interpretation of the definition of an investment contract in *Joiner* and *Howey* is also that of Professor Loss and is stated by the District Court in *Maheu* v. *Reynolds*, 282 F. Supp. 423, 429 (SDNY 1967), where the court discusses the two elements:

> "According to the complaint, plaintiffs (Maheu and Gay) invested their money in a discretionary joint account*, expecting profits solely from the efforts of Reynolds in managing it. Defendants urge that even if the joint account was managed and supervised in all respects by Reynolds, the joint account did not constitute an 'investment contract' and a 'security' within the meaning of Section 2(1) of the 1933 Act and Section 3(a) (10) of the 1934 Act because Reynolds did not offer to large numbers of similarly situated investors the opportunity to invest in pooled fund or common enterprise. *The joint account may constitute a security even if there was no pooling arrange-*

* i.e., an account carried in the name of the two plaintiffs, not a pooled fund.

> *ment or common enterprise among investors.* 1 Loss, Securities Regulation 489 (2d ed. 1961); see S.E.C. v. Payne, 35 F. Supp. 873 (S.D.N.Y. 1940); S.E.C. v. Wickham, 12 F.Supp. 245 (D.Minn. 1935). According to Professor Loss, *'the line [between what is a security and what is not] is drawn * * * where neither the element of a common enterprise nor the element of reliance on the efforts of another is present.'* 1 Loss, supra at 491." (Emphasis supplied)

In other words, if an arrangement, as in the case of a discretionary (managed) account, fits the basic definition of an investment contract, i. e., a contract or scheme for the placing of capital or laying out of money, and this takes place, as it does in the case of such accounts, in a way intended to secure income or profit solely from the efforts of the promoter or a third party, such an investment contract is a security.

Secondly, even if we assume, *arguendo,* that this Court intended that some elements of a common enterprise be present in every investment contract to constitute it a security under the Act, we believe the Court of Appeals has decided a question of federal law in conflict with the rule in *Howey* by insisting on a common enterprise of corporate character and failing to recognize that common elements in the instant scheme fit the meaning of "common enterprise" which this Court intended it to have when it defined investment contracts for purposes of the Securities Act so as:

> "* * * (to permit) the fulfillment of the statutory purpose of compelling full and fair disclosure relative to the issuance of the many types of instruments that in our commercial world fall within the ordinary concept of a security—one which embodies a flexible rather than a static principle and is capable of adapta-

tion to meet the countless and various schemes devised by those who seek to use the money of others on the promise of profits." *Howey,* op. cit., pg. 299.

In the case at bar a tripartite common enterprise existed between the investor who supplied the money, Nelson (the promoter) who supplied the trading plans and gave the orders, and the broker who made and cleared the trades. Moreover, the experience, knowledge, research and trading techniques of defendant Nelson, like Joiner's well, "run through" petitioners' accounts and the accounts of the many residents of the several states which were involved in the scheme "as the thread on which everybody's beads were strung" (320 US 348). He traded every account and although he may have traded some more or less than others or in this way rather than that way, we would surmise that not all orange groves needed or received the same care, services or attention. The trading and clearing facility and license under the Commodity Exchange Act (7 USC § 6d(1)) of the defendant broker, M-S, also runs through the accounts in similar fashion. Further, we point out, the broker was required to hold commingled in a common, segregated funds account (7 USC § 6d(2)) all of petitioners' funds, the funds of the many other discretionary account investors and all other customers' funds used in regulated commodity trading. The broker might invest these funds and retain the interest thereon (Regs. 1.25 through 1.29 Commodity Exchange Act) when such funds were not being utilized to margin commodity trades. All funds for non-regulated trading were held in a separate account which could be commingled with the broker's general funds and likewise invested. In short, a pool of capital was created for the broker and Nelson to trade and the trades were divided up among the several accounts. Obviously their business could not exist, let

alone prosper, on a single discretionary account. Also, since it was a practical impossibility for Nelson to study and research all options of all commodities on all exchanges, the evidence will show that he limited himself in the six accounts of petitioners to trading soy bean oil, and that this commodity was the principal one traded in his other discretionary accounts. But, the foregoing are not the elements of the common enterprise demanded by the court below which, we repeat, envisioned sales of units in a common enterprise "no different in operating reality from the sale of stock by a corporation." 457 F.2d at 278. Certainly, however, they fulfill all reasonable requirements of a common enterprise which this Court might consider necessary to make a basic investment contract a security under the Act.

To emphasize our point by an example: We ask the Court to consider a promoter who solicits an investor to become his limited partner. The promoter as general partner supplies the brains and controls the business; the limited partner's function is to supply only the money. The general partner takes as his profit commissions on purchases and sales made with the limited partner's money; the limited partner takes the profits or losses of the business. Whether the agreement is oral or in writing is merely an evidentiary, not a security, question.

We submit that the foregoing arrangement is an investment contract and a security regardless it is sold to one, two or many investors. The common enterprise, if it is to be a *conditio sine qua non,* is satisfied by the bilateral arrangement between the investor and promoter wherein for his profit the former relies solely upon the efforts of the latter. How much more does the case at bar exhibit elements of a "common enterprise"!

b.

If the interpretation given to the term "common enterprise" by the lower Court is allowed to stand, it will significantly limit the application of the Security Act.

If the decision below stands so that in order to be a security an investment contract must have the character of shares in a corporation, it is obvious that the ingenious promoter can, by dealing with his many investors one at a time and placing their funds in different accounts and ventures which he controls, avoid the sanctions and disclosures of the Act. In such case, the lower court holds, there is no security since there is no pooling of funds, no overall common venture embracing the several investors, and the fortune of one may ebb or flow without effect on another. *In short, the holding denies the protection of the Acts to the sole investor in any scheme regardless the type of security involved.* Could it have been the intention of Congress to afford protection to the sole buyer of shares, or bonds, or debentures, or certificate of participation in a scheme and deny it to the sole investor under an investment contract? If not, is the obverse true—i.e., that the Act's protection only applies when there are many investors, regardless the vehicle? The mischief which the lower court's decision can spawn in the whole field of security law is thus apparent.

The District Court's decision that without a common enterprise of corporate character a security is perforce exempt as a private offering likewise restricts the scope of the Act by rendering unnecessary registration provisions (15 U.S.C. §77e) of the 1933 Act, although not the sanctions of that Act or of the 1934 Act, regardless whether stock, a bond, debenture or an investment contract is sold, unless in a multi-party "common enterprise".

c.

The removal of discretionary commodity trading agreements from the pale of the Securities Act leaves the industry without effective regulation.

As we have pointed out heretofore, for 37 years since the decision in *S.E.C.* v. *Wickham* (op. cit.) in 1935, the commodity futures trading business has recognized the restraints placed upon brokers and solicitors who might be tempted, oftentimes in all good faith, to hold out hopes of fast and extraordinary profits in the commodity markets to an unsophisticated and credulous public. The cupidity of human nature is well known and when the profits which have on occasion been made in the highly volatile, risky and speculative commodity markets are advertised, the public is wont to beat a path to the door of the promoter, solicitor or broker who can write the most attractive market letter, broadside or ad. The temptation to use the technique of the discretionary trading account is especially strong in the commodity futures business since, although most people have at least a working knowledge of the stock market, the general public has little knowledge of commodities and the highly specialized procedures and techniques involved in trading them; hence, the all too prevalent offer by the over-zealous promoter, broker or salesman to accept the investor's money with the promise to make it grow for him in a managed account. This is a typical offer of the solicitor to a potential customer who replies to a solicitation that he can't trade commodities since he doesn't know how the markets work!

The decision of the court below in effect overrules *Wickham, Maheu* and *Berman* and the other S.E.C. enforcement cases, viz., *W. J. Abbott* & *Co.* and *Commodity*

Brokerage Co., Inc., all op. cit. By so doing, it has removed the protections afforded by the Acts from this high-risk, speculative form of investment and has thus denied the relief and protection which Congress intended investors in schemes like the instant one to have.

We respectfully submit that this Court should grant the Petition in order to resolve this situation. If the decision is affirmed, appropriate action may be taken by the Congress should they believe specific legislative protection is needed to replace almost four decades of judicial interpretation of the 1933 Act. Or, action may be taken by the several commodity exchanges formally to regulate such investments by their own rules in place of the regulation heretofore furnished by the Acts. If it is reversed and decisions of the District Courts in the Second, Third and Eighth Circuits thus permitted to stand, effective controls will be reestablished over a business in which opportunities to bilk the public, even by promoters with the best intentions, are so prevalent.

With the matter unresolved, we find the Seventh Circuit, which in the Chicago Board of Trade and Chicago Mercantile Exchange harbors the two largest commodity exchanges in the world, at odds with judicial determinations in the Second and Eighth Circuits which contain all of the other major U.S. Commodity Exchanges. The confusion thus resulting, we respectively argue, should not be permitted to continue. We add, further, that the conflict presents a particularly intolerable situation to brokerage houses of national character whose solicitors may now offer discretionary accounts to their customers in the Seventh Circuit states and yet be in violation not only the civil but of the criminal provisions of the 1933 and 1934 Acts in other jurisdictions.

CONCLUSION

This Court, which afforded the protections of the Act a quarter century ago to victims of over zealous oil and grove promoters by reversing the Fifth Circuit in both *Joiner* and *Howey* in what might theretofore fairly have been considered property sale cases, is here presented with a traditional investment contract security case wherein the Seventh Circuit, for reasons we believe to be *contra* the legislative intent and decisions of this Court, has in effect overruled precedents almost as old as the Security Act itself.

We therefore again pray that the writ be granted to review the judgment of the United States Court of Appeals for the Seventh Circuit.

Respectfully submitted,

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Walter H. Moses,
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Chicago, Illinois 60602
Counsel for Petitioners

APPENDIX

IN THE

UNITED STATES COURT OF APPEALS

For the Seventh Circuit

SEPTEMBER TERM, 1971 SEPTEMBER SESSION, 1971

No. 18972

ELLA MILNARIK, EMILY MILNARIK, FLORENCE MILNARIK, BRUCE TURNMIRE, JEAN MILNARIK, RONALD MILNARIK, and MARSHALL W. MILNARIK,

Plaintiffs-Appellants,

v.

M-S COMMODITIES, INC., an Illinois corporation, and DAVID S. NELSON,

Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

No. 70 C 1338

HONORABLE HUBERT L. WILL, *Judge.*

JANUARY 28, 1972

Before DUFFY, *Senior Circuit Judge,* KERNER* and STEVENS, *Circuit Judges.*

STEVENS, *Circuit Judge.* This appeal challenges the district court's holding that a discretionary trading account in commodity futures is not subject to the registration requirements of § 5 of the Securities Act of 1933, 15 U.S.C. § 77e.

* Judge Kerner heard oral argument but did not participate in the adoption of this opinion.

Plaintiffs deposited $13,662 with defendant Nelson on the understanding that he could use those funds at his discretion to trade commodity futures for the benefit of plaintiffs. Nelson made various trades on margin, resulting in a net loss greater than the amount deposited and, accordingly, made demand on plaintiffs for an additional $7,428. Plaintiffs then sought to rescind the discretionary trading account and to recover their deposit, plus interest, on the theory that their agreement with Nelson — rather than the futures contracts he had been authorized to buy and sell — was a "security" which should have been registered pursuant to 15 U.S.C. §77e.[1]

The complaint was dismissed by the district court, 320 F.Supp. 1149 (N.D.Ill. 1970), on the ground that the agreement between plaintiffs and Nelson resulted from a private rather than a public offering and, therefore, was not required to be registered even if it was a "security" within the § 77b definition.[2] Since we are persuaded that a discretionary trading account is not a security, we agree that registration was not required.

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[1] Futures contracts themselves are not securities and need not be registered under the Securities Act of 1933. See *Sinva, Inc.* v. *Merrill Lynch Pierce Fenner & Smith, Inc.*, 253 F.Supp. 359, 365-367 (S.D.N.Y. 1966). They may, of course, be regulated under other statutes. See Commodity Exchange Act, 7 U.S.C. § 1, *et seq.*

[2] "When used in this subchapter, unless the context otherwise requires—

"(1) The term 'security' means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a 'security', or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing." 15 U.S.C. §77b.

The investment contract purchased from Nelson is described in the complaint as an agreement "that Nelson should use said funds at Nelson's discretion to trade commodity futures for Milnarik's benefit and profit." It is further alleged that all trades were to be made by Nelson at the sole risk of plaintiffs and that Nelson's sole compensation would be derived upon commissions generated by his trading. Nelson, and his co-defendant principal, allegedly entered into similar discretionary contracts with numerous other customers.

Plaintiffs' position that the language of the complaint describes an investment contract covered by the Act is supported by two district court decisions[3] and by a literal interpretation of the statutory words. Nevertheless, we do not believe every conceivable arrangement that would fit a dictionary definition of an investment contract was intended to be included within the statutory definition of a security. We are "reminded that, in searching for the meaning and scope of the word 'security' in the Act, form should be disregarded for substance and the emphasis should be on economic reality." *Tchrepnin* v. *Knight*, 389 U.S. 332, 336.

Judicial analyses of the question whether particular investment contracts are "securities" within the statutory definition have repeatedly stressed the significance of finding a common enterprise. Thus, in *Tcherepnin*, which arose under the Securities Exchange Act of 1934,[4] the Court held that withdrawable shares in a savings and loan association met the test which had been stated in *S.E.C.* v. *W. J. Howey Co.*, 328 U.S. 293 at 301, and in explaining its holding said:

> "Of the several types of instruments designated as securities by § 3(a)(10 of the 1934 Act, the petitioners'

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[3] *Maheu* v. *Reynolds Co.*, 282 F.Supp. 423 (S.D.N.Y. 1968); *Berman* v. *Orimex Trading, Inc.*, 291 F.Supp. 701 (S.D.N.Y. 1968).

[4] 48 Stat. 881, 14 U.S.C. § 78a, *et seq.*

shares most closely resemble investment contracts. 'The test [for an investment contract] is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others.' [*Howey,*] at 301. Petitioners are participants in a common enterprise—a money-lending operation dependent for its success upon the skill and efforts of the management of City Savings in making sound loans. Because Illinois law ties the payment of dividends on withdrawable capital shares to an apportionment of profits, the petitioners can expect a return on their investment only if City Savings shows a profit." *Tcherepnin* v. *Knight,* 389 U.S. at 338-339.

We applied the test as quoted from the opinion in *Howey* in our recent opinion in *Kemmerer* v. *Weaver,* 445 F.2d 76, 79 (1971). We there followed the Tenth Circuit opinion in *Continental Marketing Corporation* v. *S.E.C.,* 387 F.2d 466 (1967). Excerpts from that opinion plainly identify the common enterprise as an important aspect of the court's analysis:

"The district court concluded that Continental was engaged in a common enterprise, the very heart of which was a chance to invest money through multiple contracts amounting in reality to an 'investment contract' within the meaning of the applicable statute. The subject injunction is so founded and we hold it to be legally sound.

• • •

"Investment by members of the public was a profit-making venture in a common enterprise, the success of which was inescapably tied to the efforts of the ranchers and the other defendants and not to the efforts of the investors.

• • •

"This structure into which investors entered was designed to obtain sufficient resources to produce enough domestic beavers to establish a market for its fur. If the structure collapsed then the purchasers would

> have little more than a bad investment. Certainly the beavers as mere animals and not as part of the enterprise did not have value consistent with the price many of the purchasers paid. The economic inducement was the faith or hope in the success of the enterprise — the domestic beaver industry — as a whole, and not the value of the animals alone." *Continental Marketing Corp.* v. *S.E.C.*, 387 F.2d at 469, 470, 471.

We find the element of commonality absent here. Although the complaint does allege that Nelson entered into similar discretionary arrangements with other customers, the success or failure of those other contracts had no direct impact on the profitability of plaintiffs' contract. Nelson's various customers were represented by a common agent, but they were not joint participants in the same investment enterprise.

Although the district court's holding rests on a ground that we do not reach, many of his well-reasoned observations support our conclusion that the 1933 Act was not intended to have the effect claimed by plaintiffs here. We, therefore, quote with approval the following portions of his opinion[5]:

> "The nature of a discretionary trading account makes apparent the inapplicability of the criteria generally applied by courts in determining whether or not a securities offering is public. The reported decisions deal almost exclusively with sales of stock or other fractional interests in commercial ventures, even

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[5] *Milnarik* v. *M-S Commodities*, 320 F.Supp. 1149, 1151-1152, 1153 (N.D.Ill. 1970). In the quoted excerpts we omit the district court's footnotes. Our omission of the portions of the district court's opinion discussing the plaintiffs' argument that registration of discretionary trading accounts would effectuate the policy of the statute is not intended to express either agreement or disagreement with those views; we simply find it unnecessary to comment on any question of policy in order to dispose of this appeal.

if cloaked in the guise of sales of property, where the criteria for the public versus private determination have included 1) the number of shares in the offering, 2) their respective amounts, and 3) the manner of offering, as well as the more general determination of whether the persons affected stand in need of the protection and knowledge that would be gained if the offering had been properly registered. In the instant case, the 'security' with which we are dealing is the 'investment contract' between the plaintiffs and Nelson creating the discretionary trading account. The 'security' has not been, as in the more typical situation, issued by the defendant and sold to the plaintiff. Rather, the security as we are here defining it, is an oral agency agreement in which the theoretical 'seller' becomes the agent of the 'buyer.' It is arguable that no transaction whatsoever has occurred solely as a result of the creation of the discretionary account since no interest of any kind has been 'transferred' or 'sold' to the 'buyer.' All that has happened is that the so-called 'buyer' has transferred funds to the so-called 'seller' and given him discretionary authority to enter into future transactions on the 'buyer's' behalf.

"In essence, this contract creates an agency-for-hire rather than constituting the sale of a unit of a larger enterprise. No matter how many different persons Nelson became an agent for under similar or even identical discretionary contracts, his relationship with each would remain as that of agent and principal. Each contract creating this relationship is unitary in nature and each will be a success or failure without regard to the others. Some may show a profit, some a loss, but they are independent of each other. No matter how many discretionary trading accounts Nelson may have had with other principals, the 'security' 'issued' to the plaintiffs, their discretionary trading account, could not be offered to anyone else. Although this Court recognizes that the registration requirements of Section 5 are for the protection of the public

and that any exemption therefrom must be strictly construed against one claiming it, *Securities and Exchange Commission* v. *Ralston Purina Co.*, [346 U.S. 119]; *Securities and Exchange Commission* v. *Culpepper*, 270 F.2d 241 (2d Cir. 1959), the unitary nature of the contract here involved is not overcome even when the transaction is viewed most strongly against the defendants.

"In an effort to avoid the necessary implications of the above facts, plaintiffs attempt to analogize from the many court decisions wherein single sales of property or animals to many individuals were held to be investment contracts between each individual purchaser and the common seller and thus held to be securities. The plaintiffs claim that the many individual sales of property by one seller in those cases were grouped together to reveal the public nature of the offerings; they claim that Nelson's contracting individually with many people should be viewed as a whole and thus the public nature of his offering should likewise become apparent.

* * *

"The courts, in substance, found these schemes to be attempts by promoters or entrepreneurs to create a pool of capital to be used in furthering a common enterprise by dividing up the needed base into units for individual sales. These plans, in other words, were all sales of units of a common enterprise no different in operating reality from the sale of stock by a corporation, only disguised under a veneer of property-sale terminology. Thus, although the sales of units of land in the citrus grove plus operational contracts involved in *Howey, supra* note 4, purported to be outright sales from one individual to another (and thus no different than the situation here involved), the Supreme Court specifically found that the transfers involved much more than fee simple interest in land. Rather, the Court found a scheme whereby all the individuals 'purchasing' the land in

fact were contributing money to a common enterprise and were expecting to claim their respective profits from the operations of the entire citrus grove; the resulting transfer of rights in land was considered to be purely technical. 328 U.S. 293, 299-300.

"This characteristic of common enterprise is completely lacking in the present case. Even assuming that Nelson in fact solicited and collected money from numerous parties, no allegations are made that a common enterprise existed comprised of all people possessing discretionary account contracts with him. No claim is made that Nelson traded in a uniform manner for each of these accounts. Even if he had so uniformly traded, no pooling of funds for a common purpose is alleged. Nelson was apparently simply an agent for a number of separate and distinct principals, the plaintiffs being one such principal. The plaintiffs in no way can be viewed as having invested in a common enterprise with other suppliers of venture capital. Without such common investment, the property sale cases are not analogous.

* * *

"It should be noted that the Securities and Exchange Commission apparently is of the same opinion, *i.e.*, that no public offering is involved in the creation of a discretionary brokerage account whether in securities or commodities since, we are advised, it has never proceeded against any broker or dealer soliciting and accepting such accounts solely for failure to register under the Securities Act of 1933, even though such discretionary accounts have been in widespread use during the 37 years since the Act's enactment."*

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*A portion of the district court's footnote at this point reads as follows:

"The requisite factual listings needed in a registration statement for a discretionary account would be difficult to define and the Commission would find it equally arduous to enforce accurate registration. The

Plaintiffs have pointed out that the stipulation of facts in the *Howey* case made it clear that each investor received a separate accounting with respect to the specific property which he owned, see 151 F.2d at 716, and that in *Kemmerer* the investors purchased specific beavers and relied on the defendant's expertise much as plaintiffs here relied on Nelson. But the individual aspects of the invest-

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[8] (Continued)

administration of any such registration requirements would be at least as difficult to enforce over discretionary trading acounts as it would be over other atypical types of securities as, puts and calls, which the Commission has also never required to be registered under Section 5 precisely because of these practical difficulties of administration. See, generally, 1 Loss, Securities Regulation, pp. 467-9 (2d ed. 1961)." 320 F.Supp. at 1154, n.7.

The plaintiffs have called our attention to an unreported case, *S.E.C.* v. *Commodity Brokerage Co., Inc.* (Civil 67-105, W.D.Pa. 1967) in which the S.E.C. did file a complaint against a brokerage company engaging in certain types of commodity futures transactions ("investment contracts and participation in profit sharing agreements involving purchases, sales and resales of commodity futures in managed accounts with commingled funds solicited from investors"). However, that case was settled by entry of a consent decree, apparently before any evidentiary hearing was had on the exact nature of the alleged violations. We do not think that this single case, settled by consent decree, substantially undercuts the point made by the district court. It is not clear that the present case is exactly the same as the Pennsylvania case, especially in view of the repeated references to "commingled funds" in the complaint in the Pennsylvania case. No such specific allegations have been made here.

ments in those cases did not obscure the economic reality of participation in a common enterprise.[7]

We do not believe an investor who grants discretionary authority to his broker thereby joins the broker's other customers in the kind of common enterprise that would convert the agency relationship into a statutory security.

The judgment is affirmed.

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[7] In *Howey* the Supreme Court noted that the individual investor had no right to specific fruit:

> "Without the consent of the company, the land owner or purchaser has no right of entry to market the crop; thus there is ordinarily no right to specific fruit. The company is accountable only for an allocation of the net profits based upon a check made at the time of picking. All the produce is pooled by the respondent companies, which do business under their own names." 328 U.S. at 296.

Later the Court again identified its estimate of the relative importance of the separate as opposed to the common elements of the enterprise:

> "A common enterprise managed by respondents or third parties with adequate personnel and equipment is therefore essential if the investors are to achieve their paramount aim of a return on their investments. Their respective shares in this enterprise are evidenced by land sales contracts and warranty deeds, which serve as a convenient method of determining the investors' allocable shares of the profits. The resulting transfer of rights in land is purely incidental.
>
> "Thus all the elements of a profit-seeking business venture are present here. The investors provide the capital and share in the earnings and profits; the promoters manage, control and operate the enterprise. It follows that the arrangements whereby the investors' interests are made manifest involve investment contracts, regardless of the legal terminology in which such contracts are clothed." 328 U.S. at 300.

UNITED STATES DISTRICT COURT

Northern District Of Illinois

Eastern Division

ELLA MILNARIK, EMILY MILNARIK, FLORENCE MILNARIK, BRUCE TURNMIRE, JEAN MILNARIK, RONALD MILNARIK, MARSHALL W. MILNARIK,

Plaintiffs,

v.

M-S COMMODITIES, INC., and DAVID S. NELSON,

Defendants.

70 C 1338

MEMORANDUM OPINION
(Fled Oct 26 1970)

This action presents the apparently novel question of whether or not a discretionary trading account in commodity futures is subject to the registration requirements of Section 5 of the Securities Act of 1933, 15 U.S.C. §77e. For the reasons stated below, we conclude that it is not and grant defendants' motions to dismiss plaintiffs' complaint for failure to state a claim upon which relief can be granted.

The salient allegations of plaintiffs' complaint, which are presumed true for purposes of this motion, are as follows: 1) the defendant M-S Commodities, Inc. was and is a broker trading in commodity future contracts and defendant David Nelson was its agent; 2) Nelson solicited from the plaintiffs approximately $13,500 which they deposited with him in a discretionary trading account in commodity futures; 3) the money was lost as a result of Nelson's discretionary trading; and 4) Nelson's solicitation was part of a nationwide scheme wherein defendants entered into contracts for discretionary trading accounts with various persons from numerous states. The plaintiffs do not charge defendants with any fraud, "churning" or other improper activity in the conduct of the account.

They claim relief solely because of the failure of the defendants to register these discretionary accounts under the provisions of Section 5 of the Securities Act of 1933.

Defendants' motions to dismiss are predicated upon their assertion that commodity future contracts are not securities under the Securities Act, 15 U.S.C. §77b. The Plaintiffs urge in opposition that the securities which they contend were not properly registered were *the discretionary accounts* in commodity future contracts, not the future contracts themselves. They further note that the word "securities" is defined in the Securities Act of 1933 to include "investment contracts"[1] and that Judges Bonsal and Bryan of the Southern District of New York have both concluded[2] that, although commodity future contracts themselves are not securities within the ambit of the Securities Act, discretionary trading accounts in commodity futures are investment contracts and thus are subject to the provisions of that Act.[3]

These two cases present well-reasoned and careful analyses of the definition of "securities" and offer insight into the problems of defining a term so amorphous as "investment contract."[4] However, neither of these decisions resolves the specific issue presented in the instant litiga-

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[1] 15 U.S.C. §77b(1).

[2] Maheu v. Reynolds & Co., 282 F.Supp. 423 (S.D.N.Y. 1967), Berman v. Orimex Trading, Inc., 291 F.Supp. 701 (S.D.N.Y. 1968).

[3] The Securities Exchange Act of 1934, 15 U.S.C. §§78a *et seq.*, likewise defines "security" to include, *inter alia*, "investment contracts." 15 U.S.C. §78c(10). If a discretionary trading acount in commodity futures is an investment contract and a security for purposes of the Security Act of 1933, it would likewise appear to be a security under the provisions of the Securities Exchange Act of 1934, including the anti-fraud provisions. 15 U.S.C. §78j.

[4] *Cf.*, Securities and Exchange Commission v. W.J. Howey Co., 328 U.S. 293, 66 S.Ct. 1100 (1946); Tcherepnin v. Knight, 389 U.S. 332, 88 S.Ct. 548 (1967).

tion, i.e., the applicability of the registration requirements of the 1933 Act to discretionary accounts. In this connection, we will assume, for purposes of decision on defendants' motions, that an oral contract creating a discretionary trading account in commodity futures is, as the decisions previously referred to have held, an investment contract and therefore a "security" within the meaning of the 1933 Act.

Once a security is found to be within the purview of the Securities Act, it must be registered pursuant to 15 U.S.C. §77e prior to any attempt to sell it publicly through use of the means or instrumentalities of interstate commerce. However, 15 U.S.C. §77d(2) exempts from registration any transaction by an issuer not involving a public offering. We conclude that the creation of the discretionary account at issue here, even if such an account is an investment contract and thus a security, did not involve a transaction constituting a public offering and therefore is not subject to registration.

The nature of a discretionary trading account makes apparent the inapplicability of the criteria generally applied by courts in determining whether or not a securities offering is public. The reported decisions deal almost exclusively with sales of stock or other fractional interests in commercial ventures, even if cloaked in the guise of sales of property, where the criteria for the public versus private determination have included 1) the number of shares in the offering, 2) their respective amounts, and 3) the manner of offering, as well as the more general determination of whether the persons affected stand in need of the protection and knowledge that would be gained if the offering had been properly registered.[5] In the instant

[5] Securities and Exchange Commission v. Ralston Purina Co., 346 U.S. 119, 73 S.Ct. 981 (1952), corporate shares offered to "key" employees of corporation; Garfield v. Strain, 320 F.2d 116 (10 Cir. 1963), partial interest in oil and gas lease; U.S. v. Custer Channel Wing Corp., 376 F.2d 675 (4 Cir. 1967), *cert. denied* 389 U.S. 850, S.Ct. 38, 1,579,590 shares of corporate stock; Strahan v. Pedroni, 387 F.2d 730 (5 Cir. 1967), fractional shares of gas wells.

case, the "security" with which we are dealing is the "investment contract" between the plaintiffs and Nelson creating the discretionary trading account. The "security" has not been, as in the more typical situation, issued by the defendant and sold to the plaintiff. Rather, the security as we are here defining it, is an oral agency agreement in which the theoretical "seller" becomes the agent of the "buyer." It is arguable that no transaction whatsoever has occurred solely as a result of the creation of the discretionary account since no interest of any kind has been "transferred" or "sold" to the "buyer." All that has happened is that the so-called "buyer" has transferred funds to the so-called "seller" and given him discretionary authority to enter into future transactions on the "buyer's" behalf.

In essence, this contract creates an agency-for-hire rather than constituting the sale of a unit of a larger enterprise. No matter how many different persons Nelson became an agent for under similar or even identical discretionary contracts, his relationship with each would remain as that of agent and principal. Each contract creating this relationship is unitary in nature and each will be a success or failure without regard to the others. Some may show a profit, some a loss, but they are independent of each other. No matter how many discretionary trading accounts Nelson may have had with other principals, the "security" "issued" to the plaintiffs, their discretionary trading account, could not be offered to anyone else. Although this Court recognizes that the registration requirements of Section 5 are for the protection of the public and that any exemption therefrom must be strictly construed against one claiming it, *Securities and Exchange Commission* v. *Ralston Purina Co., supra* note 5; *Securities and Exchange Commission* v. *Culpepper,* 270 F.2d 241 (2d Cir. 1959), the unitary nature of the contract here involved is not overcome even when the transaction is viewed most strongly against the defendants.

In an effort to avoid the necessary implications of the above facts, plaintiffs attempt to analogize from the many

court decisions wherein single sales of property or animals to many individuals were held to be investment contracts between each individual purchaser and the common seller and thus held to be securities.[6] The plaintiffs claim that the many individual sales of property by one seller in those cases were grouped together to reveal the public nature of the offerings; they claim that Nelson's contracting individually with many people should be viewed as a whole and Exchange Commission v. C.M. Joiner Leasing Corp., become apparent.

This analogy fails for two reasons. The basic issue presented and resolved in the many prior decisions to which plaintiffs refer was whether or not a purported sale of property was in fact an investment contract and therefore a "security" and not whether its sale constituted a public offering. Moreover, the basis of these decisions is inconsistent with a finding that the instant discretionary account is part of a public offering. In these purported property sale cases, the courts, in finding the transactions to be investment contracts, relied specifically on the nature of the contracts and the schemes involved.

The courts, in substance, found these schemes to be attempts by promoters or entrepreneurs to create a pool of capital to be used in furthering a common enterprise by dividing up the needed base into units for individual

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[6] *See, e.g.,* Securities and Exchange Commission v. Howey, *supra* note 4, sales of units in a large citrus fruit enterprise coupled with service contracts and land sale contracts; Blackwell v. Bentsen, 203 F.2d 690 (5 Cir. 1953), *cert. denied* 346 U.S. 908, 74 S.Ct. 240 (1953), sales of portions of 800 acre tract to be developed as citrus grove accompanied by separate contract with sellers for the latter to manage the property; Securities and Exchange Commission v. Payne, 35 F.Supp. 878 (S.D.N.Y. 1940), contract for sale of silver foxes by fox ranch operator together with agreements to care for foxes for purchasers. For other instances where purported sales of property have been held to be investment contracts, see Securities and Exchange Commission v. C. M. Joiner Leasing Corp., 320 U.S. 344, n. 10, at p. 352.

sales. These plans, in other words, were all sales of units of a common enterprise no different in operating reality from the sale of stock by a corporation, only disguised under a veneer of property-sale terminology. Thus, although the sales of units of land in the citrus grove plus operational contracts involved in *Howey, supra* note 4, purported to be outright sales from one individual to another (and thus no different than the situation here involved), the Supreme Court specifically found that the transfers involved much more than fee simple interest in land. Rather, the Court found a scheme whereby all the individuals "purchasing" the land in fact were contributing money to a common enterprise and were expecting to claim their respective profits from the operations of the entire citrus grove; the resulting transfer of rights in land was considered to be purely technical. 328 U.S. 293, 299-300.

This characteristic of common enterprise is completely lacking in the present case. Even assuming that Nelson in fact solicited and collected money from numerous parties, no allegations are made that a common enterprise existed comprised of all people possessing discretionary account contracts with him. No claim is made that Nelson traded in a uniform manner for each of these accounts. Even if he had so uniformly traded, no pooling of funds for a common purpose is alleged. Nelson was apparently simply an agent for a number of separate and distinct principals, the plaintiffs being one such principal. The plaintiffs in no way can be viewed as having invested in a common enterprise with other suppliers of venture capital. Without such common investment, the property sale cases are not analogous.

In this connection, it is also apparent that the creation of the discretionary account was not a public offering under the accepted criteria for determining whether or not a securities offering is a public offering. For purposes of this discussion, we again assume that the discretionary trading account in commodity futures is a security as defined in the 1933 and 1934 Acts, that Nelson "issued" such security to plaintiffs, and that the standard criteria

for determining a public offering are applicable. These criteria, as discussed *supra,* include the number, amount, and manner of the offering, and, finally, whether or not the particular class of persons affected will be beneficially protected by applying the Act to them. *Securities and Exchange Commission* v. *Ralston Purina Co.,* supra note 5, at p. 125. Certainly the number, amount, and manner of the offering of this security to the plaintiffs negate any "public" tenor thereto. Nelson offered the plaintiffs a single agency contract totally unrelated to any other agency contract he might offer to others and the amount involved was only slightly more than $13,500.00. "The whole tenor of the Act indicates a congressional purpose to require an accompanying registration statement with the offer or sale of a conventional issue of securities to the general public or a particular class thereof, and to exempt isolated transactions from the burdens of registration requirements" *Woodward* v. *Wright,* 266 F.2d 108, 115 (10 Cir. 1959). While an offering may be public when offered to many or to few, *Securities and Exchange Commission* v. *Ralston Purina Co., supra* note 5, at p. 125, an offering has never been held to be a public offering when it has been extended to only one person.

The most significant single standard criterion in making the public versus private determination is the need of the persons affected for the information contained in a registration statement, i.e., whether there is any practical need for the Act's application. A perusal of the information required in the registration statement, 15 U.S.C. §§77aa, Schedule A, demonstrates the inapplicability of a typical registration statement to the instant situation. Required in any such statement, *inter alia,* are the following: the name of the state under which the issuer is organized; the names and addresses of all persons owning more than ten per cent of the stock of the issuer; a statement of the capitalization of the issuer; the amount of any funded debt to be created by the security offered; the purposes for which the funds received from the issuance of the security will be used; the price at which the security shall

be offered to the public; the commissions to be paid to underwriters in respect of the sale of the offered security; a balance sheet showing all of the assets of the issuer; and a profit and loss statement of the issuer. Should this information have been required of Nelson, he would have listed in statement form: where he was organized; who owned stock in him; his capitalization; any funded debt resulting from the discretionary account; the fact that these incoming funds deposited in the discretionary trading account in commodity futures would be used for discretionary trading in commodity futures; the price at which the discretionary account was being offered; a balance sheet showing his personal assets; and a personal profit and loss statement from the prior year.

While the Commission could undoubtedly devise a special form, it is apparent that all of the information required in a typical registration statement by 15 U.S.C. §77aa, Schedule A, is either totally inapplicable or would provide no information even plausibly relevant to the plaintiffs. No practical need or purpose thus exists for the application of the registration requirements of the Securities Act.

It should be noted that the Securities and Exchange Commission apparently is of the same opinion, i.e., that no public offering is involved in the creation of a discretionary brokerage account whether in securities or commodities since, we are advised, it has never proceeded against any broker or dealer soliciting and accepting such accounts solely for failure to register under the Securities Act of 1933, even though such discretionary accounts have been in widespread use during the 37 years since the Act's enactment.[7]

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[7] In addition to the lack of any real benefits that would have been afforded to the plaintiffs had this "security" been registered, there are obvious practical difficulties of administration that would flow from requiring such registration. The requisite factual listings needed in a registration statement for a discretionary account would be diffi-

Because plaintiffs claim relief solely because of the defendants' failure to register their discretionary trading account under Section 5 of the Securities Act of 1933, we find, for the aforementioned reasons, that their complaint fails to state a cause of action upon which relief can be granted. The complaint, therefore, is dismissed. An appropriate order will enter.

/s/ Hubert L. Will
United States District Judge

Dated: October 26, 1970

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[7] (Continued)
cult to define and the Commission would find it equally arduous to enforce accurate registration. The administration of any such registration requirements would be at least as difficult to enforce over discretionary trading accounts as it would be over such other atypical types of securities as puts and calls, which the Commission has also never required to be registered under Section 5 precisely because of these practical difficulties of administration. See, generally, 1 Loss, Securities Regulation, pp. 467-9 (2d ed. 1961).

United States Court of Appeals

For the Seventh Circuit

Chicago, Illinois 60604

March 13, 1972

Before

Hon. R. Ryan Duffy, Sr. Circuit Judge

Hon. John Paul Stevens, Circuit Judge

ELLA MILNARIK, et al., *Plaintiffs-Appellants,* vs. M-S COMMODITIES, INC., and DAVID S. NELSON *Defendants-Appellees.*	Appeal from the United States District Court for the Northern District of Illinois, Eastern Division. (70 C 1338)

No. 8972

On consideration of the petition for rehearing and suggestion that it be heard *en banc* filed in the above-entitled cause, no judge in active service having requested a vote thereon, nor any judge voted to grant the suggestion, and a majority of the members of the panel having voted to deny a rehearing,

IT IS ORDERED that the petition for a rehearing in the above-entitled cause be and the same is hereby denied.

Judge Kerner participated in the decision but did not participate in the consideration of the petition for rehearing.

APPENDIX

§ 6d. Futures commission merchants, dealing by unregistered merchants prohibited; moneys and securities of customers, care and use.

It shall be unlawful for any person to engage as futures commission merchant in soliciting orders or accepting orders for the purchase or sale of any commodity for future delivery, or involving any contracts of sale of any commodity for future delivery, on or subject to the rules of any contract market unless—

(1) such person shall have registered, under this chapter, with the Secretary of Agriculture as such futures commission merchant and such registration shall not have expired nor been suspended nor revoked; and

(2) such person shall, whether a member or nonmember of a contract market, treat and deal with all money, securities, and property received by such person to margin, guarantee, or secure the trades or contracts of any customer of such person, or accruing to such customer as the result of such trades or contracts, as belonging to such customer. Such money, securities, and property shall be separately accounted for and shall not be commingled with the funds of such commission merchant or be used to margin or guarantee the trades or contracts, or to secure or extend the credit, of any customer or person other than the one for whom the same are held: *Provided, however,* That such money, securities, and property of the customers of such futures commission merchant may, for convenience, be commingled and deposited in the same account or accounts with any bank or trust company or with the clearing house organization of such contract market, and that such share thereof as in the normal course of business shall be necessary

to margin, guarantee, secure, transfer, adjust, or settle the contracts or trades of such customers, or resulting market positions, with the clearinghouse organization of such contract market or with any member of such contract market, may be withdrawn and applied to such purposes, including the payment of commissions, brokerage, interest, taxes, storage, and other charges, lawfully accruing in connection with such contracts and trades: *Provided further*, That such money may be invested in obligations of the United States, in general obligations of any State or of any political subdivision thereof, in obligations fully guaranteed as to principal and interest by the United States, and in "investment securities" as defined in and under authority of section 24 of Title 12 and, subject to approval by the Secretary of Agriculture, may be loaned on the security of negotiable warehouse receipts conveying or securing title to readily marketable commodities to the extent of the current loan value of such receipts, such investments and loans to be made in accordance with such rules and regulations and subject to such conditions as the Secretary of Agriculture may prescribe.

Sept. 21, 1922, c. 369, § 4d, as added June 15, 1963, c. 545, § 5, 49 Stat. 1494.

Sec. 1.25 Investment of customer's funds. No futures commission merchant and no clearing organization of a contract market shall invest funds belonging to commodity customers except in obligations of the United States, in general obligations of any State or of any political subdivision thereof, or in obligations fully guaranteed as to principal and interest by the United States. Such investments shall be made through an account or accounts used for the deposit of customers' funds and proceeds from any sale of such obligations shall be redeposited in such account or accounts.

Sec. 1.29 Increment or interest resulting from investment of customers' funds. The investment of customers' funds in obligations described in section 1.25, shall not operate to prevent the futures commission merchant or clearing organization so investing such funds from receiving and retaining as its own an increment or interest resulting therefrom.